

Factors That Affect Tax Compliance Behavior of Small and Medium Enterprises: Evidence from Nekemte City

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Abstract

The main objective of the study was to assess factors that affect tax compliance behavior of small and medium enterprises taxpayer in nekemte city administration. The study used descriptive and explanatory research design. The total population of the study was 8458 small and medium business enterprises in nekemte city from which the sample of 386 were determined for data collection. To ensure the representativeness of different business sectors of small and medium enterprises taxpayers, stratified sampling technique was adopted. In order to gather the required data, structured questionnaires have been used. Data collected was analyzed by Statistical Package for Social Science version 24 and the findings were presented using tables and figures. The finding shows that tax rate have statistically significant negative effect on tax compliance behavior of small and medium enterprises tax payers, but the level of income, fine and penalty, Rewarding and incentives, simplicity of tax system, perceptions of government spending, tax audit, Attitude toward tax and tax knowledge and awareness were statistically, significantly and positively associated with tax compliance behavior of small and medium enterprises tax payers. The study recommended that management of tax revenue authority has keep tax rates to the minimum as much as possible, putting legal sanctions in terms of penalties and fines on non compliant SME tax payers, simplify filling and tax collection procedures, maintain transparency on how the revenue collected from taxation was being expended. Provide tax rewards and incentives to honest tax payers, educating the taxpayers to create the necessary awareness on tax laws and the detection of noncompliance so as to increases tax compliance behavior of SME taxpayers.

Keywords: tax compliance behavior, Small and medium enterprises

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1.1. INTRODUCTION

A country's development and growth is generally dependent on the revenue level obtained (Samuel & Dieu, 2014), and in this regard, taxes form one of the top major national revenue sources all over the globe (Alshir'ah, Abdul-Jabbar, & Samsudin, 2016). Tax revenues are the lifeblood of the social contract (Worlu & Nkoro, 2012) and become the central to economic, social and political development (Marandu, Mbekomize, & Ifezue, 2014). Government use taxation to raise revenues to cover their expenditures on the provision of social goods and services, to regulate the level of spending in the economy, redistribute income among the populace and control imports into the country. However, tax collection is the major challenging that has attracted increasing attention in the last two decades (Nigam, 2016; Muslichah, 2015) for financing government expenditure (Worlu & Nkoro, 2012) and funding of public goods and services (Muslichah, 2015). Most governments of developing countries are facing difficulty in collecting tax they need because of tax noncompliance reason (Ahmed & Kedir, 2015). There is widespread tax avoidance and evasion in most African countries (Ali, Fjeldstad, & Sjursen, 2013). Also, most tax payers are reluctant to pay tax in at the right amount, time and place (Ahmed & Kedir, 2015).

In order to mitigate the difficulty of tax collection, a good tax system is essential (Muslichah, 2015). Tax law specifies the processes and procedures that tax payers' need for voluntarily tax comply (Daniel, Akowe, & Awaje, 2016). Tax administration is a requisite for ensuring high compliance and administering tax policies (Olaoye, Agbaje, & Ajewole, 2017). The abilities of Governments' to collect taxes depend on people's willingness to pay (Eiya, Ilaboya, & Okoye, 2016; Fjeldstad, 2016) and requires strong understanding of factors underlying taxpayers' decision about whether to pay or evade taxes (Ali, Fjeldstad, & Sjursen, 2013). Understanding taxpayers' attitudes and behaviors toward voluntary tax compliance is constructive for tax authority (Fjeldstad, 2016; Ahmed & Kedir, 2015; Ali, Fjeldstad, & Sjursen, 2013).

Tax compliance is a major problem for many tax authorities and it is not an easy task to persuade taxpayers to comply with tax requirements even though tax laws are not always precise (James & Alley, 2014). Tax Compliance can be referred to as the process in which tax returns required to be submitted to the tax authorities are filed at the appropriate time with the accurate tax liability as required under the tax laws and regulations of a country (Friedman, 2011). Tax compliance is the degree to which taxpayer complies or fails to comply with the tax rules of his country (Ahmed & Kedir, 2015). Tax compliance is the accurate reporting of income and claiming of expenses in accordance with stipulated tax laws (Mas'ud, Aliyu, & Gambo, 2014; Sapiei, Kasipillai, & Eze, 2014). It is the process of fulfilling tax payer's civil obligation for tax payment, filing of tax returns and explanations required by tax authority in a timely manner (Daniel, Akowe, & Awaje, 2016). Tax compliance is

the willingness of individuals to comply with relevant tax authorities by paying their taxes (Appah & Wosowei, 2016; Gadi, 2016). Tax compliance is global phenomena hassling both developed and developing countries (Mas'ud, Aliyu, & Gambo, 2014; Mohdali & Pope, 2014) and become the major concern for all tax administrations (Damayanti, Sutrisno, Subekti, & Baridwan, 2015; Thúc, 2013).

The tax compliance is influenced by economic, social and psychological factors (Heenkenda, Weerasekara, & Chathurangani, 2016). The economic deterrence of tax compliance is influenced by tax rate, benefits of evasion, probability of detection and penalties for fraud (Heenkenda, Weerasekara, & Chathurangani, 2016). Social norms constructed through social pressure that influences people attitude towards tax compliance (Damayanti, Sutrisno, Subekti, & Baridwan, 2015). Tax compliance is mostly influenced by government expenditure on public goods and services (Damayanti, Sutrisno, Subekti, & Baridwan, 2015).

According to OECD (2008) for most small and medium businesses, tax compliance is associated with heavy costs due to the various limitations they face, particularly in maintaining proper and sufficient records for management and taxation purposes. There are also various determinant factors that may affect tax compliance by SMEs to different tax rules, regulations and proclamations. Hence this study focuses on identifying factors that may determine the tax compliance behavior of small and medium enterprises tax payers in the study area.

1.2. Statement of the Problem

Tax compliance is the degree to which taxpayer complies or fails to comply with tax rules of the country (Eiya, Ilaboya, & Okoye, 2016; Ahmed & Kedir, 2015). However, there are different determinants of tax compliance that are classified differently by different researchers in which most of them overlaps (Ahmed & Kedir, 2015). For instance, individual decisions on tax compliance are categorized as: industry factors; accounting factors; psychosocial factors; tax administration factors; and economic factors (Thúc, 2013). Also, tax compliance on social and psychological theories argued as human element plays a vital role in tax compliance decisions (Devos, 2014). Similarly, the study by (Beesoon, Soondram, & Jugurnath, 2016) categorized tax compliance factors as economic, institutional, social and individual factors. Moreover, (Ahmed & Kedir, 2015) classified determinants of tax compliance as economic, tax system, demographic, social, and individual groups. All the above categories indicate as there were no clear cut categories on determinants of tax compliance factors.

Also, the study by (Nigam, 2016) on determinants of tax compliance revealed tax burden in terms of tax rates is the main reason behind tax evasion in which almost all studies reviewed and found tax rates has a negative influence on tax compliance; legal sanctions in terms of penalties and fines shows a mixed result in which five studies displayed positive association, one negative relationship and one showed no association; the probability of being audited reviewed reveals five studies displayed positive association and one study showed negative relationship; and four studies displayed positive association, three of them showed negative relationship and one study showed no association between income with tax compliance.

Similarly, the study by (Fjeldstad, 2016) on factors determining citizens' tax compliance attitude shows that tax compliance attitude is positively correlated with the provision of public services. The study by (Heenkenda, Weerasekara, & Chathurangani, 2016) on tax compliance factors found tax amounts, perceptions towards government spending, referent group and income level have significant positive correlation with tax compliance. The study by (Olaoye, Agbaje, & Ajewole, 2017) found tax information and tax knowledge shows positive significant impacts on tax compliance while tax administration shows an insignificant impact on tax compliance.

There are few studies done on tax compliance in Ethiopia (Ahmed & Kedir, 2015). For example, the studies by (Engida & Baisa, 2014; Tehulu & Dinberu, 2014) on determinants of tax compliance of Category "A" taxpayers in Bahir Dar found tax payers perception on government spending; perception on equity and fairness of the tax system; penalties; personal financial constraint; changes on current government policies and referral group significantly affect tax compliance behavior.

Also, the study by (Mehari & Pasha, 2017) on voluntary tax compliance in Arba Minch found efficiency and effectiveness of awareness creation; enforcing tax law and socio-cultural factors positively affect tax compliance of category 'C' taxpayers.

Moreover, tax compliance studies shows as there is no agreement as to why people do or do not pay their taxes (Devos, 2014) as factors influencing tax compliance is a complex (Mohdali & Pope, 2014) and are too many different explanatory factors of tax compliance (Nigam, 2016; Marandu, Mbekomize, & Ifezue, 2014).

In our country, even though few study have been conducted on the factors that affect tax compliance behavior of tax payers, no attention have been given by researchers on the factors that affect the tax compliance of small and medium enterprises. A number of Ethiopian small and medium business operators choose to remain in the informal sector and a considerable number of those who pay taxes only do so because they are forced by ERCA (Ethiopian Development Research Institute, 2014). Tax non compliance is a serious challenge facing income tax administration and hindering tax revenue performance (Friedman, 2011). This is also true in the case of Nekemte city revenue authority. Thus, this study tried to assess determinant factors of tax compliance behavior of small and medium enterprise tax payers in case of nekemte city found in East Wollega zone.

1.3. Objectives of the Study

1.3.1. General objective

The general objective of the study is to assess factors that affect tax compliance among small and medium enterprises in the case of nekemte city east wollega Zone.

1.3.2. Specific objectives

Specifically, the study tries:

- ✓ To analyze how economic factors (tax rate, income level and fine and penalty, Rewards and Incentives,) that influence tax compliance of small and medium enterprises tax payers in nekemte city
- ✓ To analyze how tax system related factors (simplicity of tax system and perceptions of government spending and tax audit) that influence tax compliance of small and medium enterprises tax payers in nekemte city
- ✓ To analyze how individual factors (attitude toward taxes, tax knowledge and awareness) influence tax compliance of small and medium enterprises tax payers in nekemte city

1.4. Scope of the Study

This study was conducted on factors that affect tax compliance among small and medium enterprises in the case of nekemte city east wollega Zone Using economic factors (tax rate, income level and fine and penalty tax Awards & incentives), tax system related factors (simplicity of tax system and perceptions of government spending and tax audit) and non individual factors (attitude toward taxes, Tax knowledge and Awareness). Important information on factors that affect tax compliance of small and medium enterprises was collected from 386 SME business taxpayers that found in Nekemte city.

2. LITERATURE REVIEW

This section describes review of theoretical and empirical literature. From the theoretical part, first it tries to describe definition of tax compliance and tax compliance theories followed by empirical literature; and conceptual frame work of the study are discussed respectively.

2.1. Definition of Tax compliance

Tax compliance is defined as the accurate reporting of income and claiming of expenses in accordance with stipulated tax laws (Sapiei, Kasipillai, & Eze, 2014). Tax compliance is the degree to which a taxpayer complies or fails to comply with the tax rules of their country (Eiya, Ilaboya, & Okoye, 2016; Gadi, 2016; Manual & Xin, 2016). Tax non-compliance is the failure of taxpayer to meet tax obligations (Tehulu & Dinberu, 2014) or failure of tax payer to accurately report or pay tax levied (Sapiei, Kasipillai, & Eze, 2014).

2.2. Tax Compliance Theories

The use of theory enhances understanding of factors that affect tax compliance (Marandu, Mbekomize, & Ifezue, 2014). There are two main approaches to understand tax compliance issues: the economic approach and behavioral approach. The economic approach is premised on the concept of economic rationality and the behavioral approach applies from disciplines of psychology and sociology (Devos, 2014; Sapiei, Kasipillai, & Eze, 2014). Tax compliance literature suggested three theories borrowed from economics and psychological sciences that are classified as Allingham and Sandmo (1972) model; institutional Anomie Theory and the Theory of Planned Behavior (Nigam, 2016; Marandu, Mbekomize, & Ifezue, 2014). The tax compliance theories are complementary rather than competing with each other (Ali, Fjeldstad, & Sjursen, 2013). Each theory emphasizes different aspects of determinants of tax compliance that contributes towards better understanding of tax compliance and no single theory has been invented to incorporate all predictors of tax compliance (Marandu, Mbekomize, & Ifezue, 2014).

2.3. Empirical Literature

Mehari & Pasha (2017) conducted a study on taxpayers' attitude to factors that affect voluntary compliance of taxpayers in Arba Minch City using primary data collected via self administered questionnaires which include both open and close ended questions from the sampled category 'C' taxpayers. The study found lack of awareness as major and leading reason for non-existence of voluntary compliance among category 'C' taxpayers. Further, efficiency and effectiveness of the authority in improving the tax assessment and collection procedures, creating awareness, enforcing the tax law positively affect voluntary tax compliance of taxpayers. Socio-cultural factors also affect attitude of taxpayers towards taxation positively as well as negatively. However, political related factors were found insignificant in this survey.

Olaoye, Agbaje, & Ajewole (2017) examined the impact of tax information, administration and knowledge on taxpayers' compliance in Nigeria using a survey research design and collected data using questionnaire and analyzed using linear regression method. The results reveals that tax information and knowledge had positive significant impacts on tax compliance while tax administration had an insignificant impact on tax compliance

indicating tax information and tax knowledge has higher tendency to promote tax compliance than tax administration.

Appah & Wosowei(2016) investigated tax compliance intentions and behavior of the individual taxpayer in Nigeria using secondary and primary data collected using structured questionnaire of 4 sections of 47 items from 785 respondents and analyzed using multiple regression models. The result revealed that there is a significant relationship between tax compliance intentions and equity attitudes; tax compliance intentions and social and moral norm variables; and tax compliance intentions and risk and penalties. The study concludes that the behavior of an average taxpayer should be examined on the basis of financial condition, risk preference, nature of the society in terms of the level of governance.

Daniel, Akowe, & Awaje (2016) analysed tax compliance behavior of small scale enterprises in Bassa and found taxpayers' social factors have significant influence on tax compliance level. Low tax education and high cost of tax compliance were also factors reducing tax compliance level. The study also revealed taxpayers' demographical factors have significant effect on compliance level among which the risk of tax non-compliance in younger people was more than the older ones; the risk of tax non-compliance in male was higher than the female gender, educated people avoid and evade taxes more than the uneducated ones and the high income earners evade taxes more than the low income earners.

Eiya, Ilaboyaand Okoye (2016) empirically examined the influence of religiosity on tax compliance using a cross-sectional survey research design to get the opinion of taxpayers about tax compliance in Nigeria by using data collected by questionnaire and analyzed by descriptive statistics, analysis of variance (ANOVA and regression analysis found that there was no significant difference in tax compliance behavior between Christians and Muslims taxpayers. They concluded religious values have no significant role in making taxpayers liable for tax compliance. The study also found that taxpayers are not strongly influenced by the threat of punishment employed by the tax authority in Nigeria.

Gadi (2016) conducted study on factors affecting tax compliance of formal and informal sectors using multinomial logistic regression analysis of data collected from 793 respondents in Rwanda and found that the level of income, compliance costs, penalty rate, attitudes towards taxes, equity and fairness of the tax system and social norms are statistically significantly affect tax compliance levels in the formal business sectors whereas only attitude towards taxes and perception of government spending were statistically significantly influence tax compliance behavior in the informal business sectors.

Ahmed & Kedir (2015), conducted a study toinvestigate determinants of tax compliance in Jimma zone using data collected from 384 categories "A" taxpayers and fund age, sex, penalty, audit, simplicity, fairness and government perception were found to affect tax compliance. The study recommended the tax authority has to work on tax education, try to make the whole tax system as fair as possible with regard to the tax burden of paying, has to expand and make more regular and consistent auditing, work on bringing a good reputation through providing public service, making the tax system simple on the laws, the forms, the filling, the paying and appeal system in order to increase tax compliance and tax revenue.

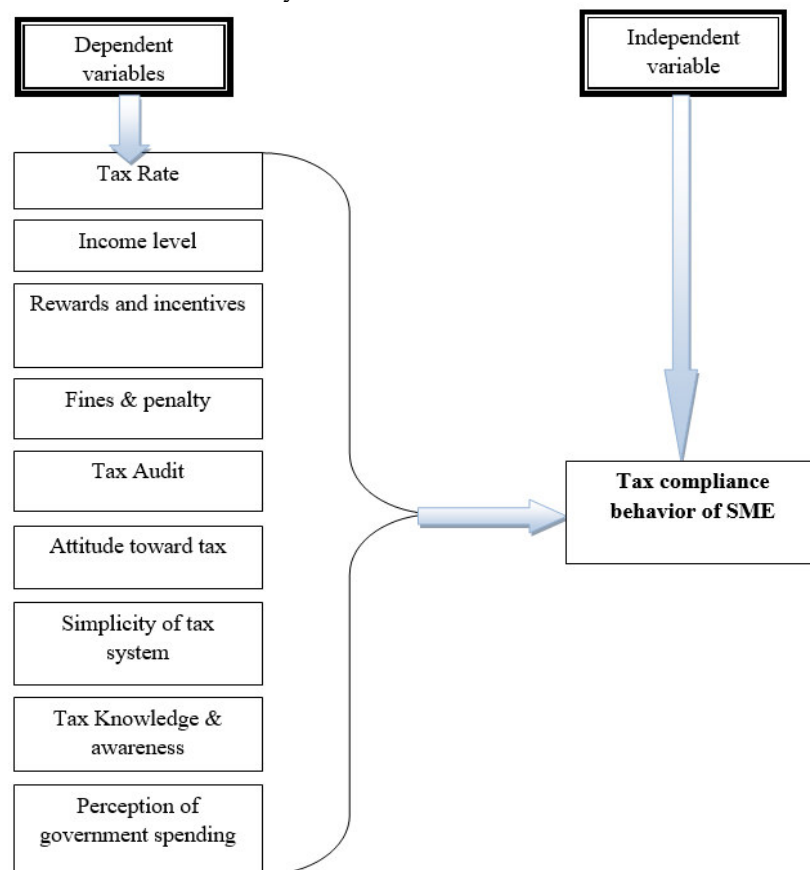
Tehulu & Dinberu (2014) conducted a study on determinants of tax compliance behavior in Bahir Dar city in 2014 using data collected by Likert scale questionnaire and analyzed by one-way ANOVA, two samples and one sample T-test. The result of the study revealed that perception on government spending, perception on equity and fairness of tax system, penalties; personal financial constraint, changes on current government policies and referral group (friends, relatives etc.) are factors that significantly affect tax compliance behavior. Also, their findings show that older people will comply less on equity and fairness in the tax system. However, gender and probability of being audited have no significant impact on tax compliance behavior.

2.4. Conceptual Frame Work of the Study

The use of tax compliance theory enhances understanding about factors that affect tax compliance behavior (Nigam, 2016). The conceptual framework of this study relies on tax compliance theories that exists in pieces and comes together into a coherent package of conventional wisdom (Marandu, Mbekomize, & Ifezue, 2014). Examining taxpayer tax compliance behavior is complex and challenging as the relevant literature emanates from a variety of disciplines including economics, psychology and sociology. In this regard, this study will apply a blend of different tax compliance approaches that seems most appropriate as a single approach in assessing the tax compliance behavior applied by (Sapiei, Kasipillai, & Eze, 2014).

Thus, the conceptual frame work for the study is developed based on previous studies conducted by(Olaoye, Agbaje, & Ajewole, 2017; Ahmed & Kedir, 2015; Engida & Baisa, 2014; Thúc, 2013) and used in their study all or some of economic factors, tax system and individual factors that influence taxpayer's tax compliance behavior as shown by the following figure.

Figure 1: Conceptual frame work of the study



Source: Own compilation based on the work of (Olaoye, Agbaje, & Ajewole, 2017; Ahmed & Kedir, 2015; Engida & Baisa, 2014) and literature

3. RESEARCH METHODOLOGY

3.1. Research Design

The research design employed for this work is explanatory research design that employs survey method of data collection. It is selected on the assumption that it helps to gather adequate information and is more relevant to determine opinions of the taxpayers and helps to obtain the knowledge and experience from those who are familiar with the issue to identify the factors affecting tax compliance of small and medium business profit taxpayers based in Nekemte City Administration. The selection of survey method was attributed for the fact that the method facilitates the collection of original data necessary for realizing the research objectives. The survey method was an appropriate for collecting useful data that reports representation of the real situation or characteristic in the study population for the investigation of factors that affects taxpayers' tax compliance of small and medium enterprises in Nekemte city.

3.2. Data Source and Type

The source of data used in this study was primary sources of data. In order to conduct an assessment on the factors affecting tax compliance of small and medium business enterprises, the researcher collected primary data from randomly selected categories of all medium and small enterprises found in Nekemte city administration using structured questionnaires adopted from relevant literature previously done on tax compliance behavior of tax payer in different countries.

3.3. Target Population of the Study

As the study assessed factors that affect tax compliance of small and medium business enterprises in the case of Nekemte city, the total population used to determine the sample was all active small and medium business enterprises taxpayers in Nekemte city Administration. According to the records on January, 2020 of the Nekemte SME office, the total number of active small and medium business taxpayers was 8458. Thus, the target population of the study comprises of 8458 of small and medium business enterprises which was used to determine the sample sized under this study. The target population of the study is presented in the following table

Table 3.1: Target Population of the Study

S.No	Type of sectors	No. of MSEs
1	Trade	1983
2	Services	3599
3	Manufacturing	1288
4	Construction	1215
5	Agriculture	148
6	Dairy	132
7	Mining	93
Total		8458

Source: Nekemte SME office, 2020

3.4. Sampling Size Determination

The sample size was determined from the total population of 8458 small and medium business enterprises found in Nekemte city. The research was conducted with 5percent marginal error and 95 percent confidence interval and none response rate of 5percent. Based on this assumption, the actual sample size for the study was determined by using (Watson, How to Determine a Sample Size: Tipsheet #60, University Park, PA: Penn State Cooperative Extension., 2001) methods of sample size determination formula to reach at the required sample size.

$$n = \frac{\left(\frac{P(1-P)}{A^2} \right) \left(\frac{0.5(1-0.5)}{0.05^2} \right) \left(\frac{0.25}{0.0025} \right) \left(\frac{0.25}{0.0006803353} \right)}{R} = \frac{\left(\frac{0.5(1-0.5)}{0.05^2} \right) \left(\frac{0.25}{0.0025} \right) \left(\frac{0.25}{0.0006803353} \right)}{0.95} = \frac{(367.466)}{0.95} = 386$$

Where: n = Sample size required for the study from the total population;

N= Total number of small and medium enterprises (8458).

P= Estimated variance among all SME as a decimal of 0.5 for 50-50; that indicate variability of tax payers understanding about factors that affect tax in Nekemte city.

A= Precision desired, expressed as decimal of 0.05 for 5 percent;

Z= Confidence level of 1.96 for 95 percent; and

R= Estimated response rate, as decimal of 0.95 for 95 percent response to be returned.

3.5. Sampling Procedure

The most important characteristic of a sample is its representativeness, not its size. Therefore, a sample of 386 small and medium business enterprises was selected from a population of 8458 small and medium business profit taxpayers in Nekemte city. The total population is stratified into sectors and the sample of 386 was draw from the total population from each sectors based on their proportion as shown in table 3.2. Following this, convenient sampling technique was used to collect the required data from small and medium business enterprises. Finally, the required data was collected from 386 SME business found in nekemte city.

Table 3.2: Target Population of the Study

No.	Type of sectors	Population	Proportion	Determined sample
1	Trade	1983	0.0456	91
2	Services	3599	0.0456	164
3	Manufacturing	1288	0.0456	59
4	Construction	1215	0.0456	55
5	Agriculture	148	0.0456	7
6	Dairy	132	0.0456	6
7	Mining	93	0.0456	4
Total business taxpayers		8458	0.0456	386

Source: Own computation based on data from Nekemte SME office, 2020

3.6. Data Collection methods

This study based on primary data collected using structured questionnaires. Data collection tool was developed based on previous studies conducted by (Mehari & Pasha, 2017; Redae & Sekhon, 2017; Ahmed & Kedir, 2015; Sapiei, Kasipillai, & Eze, 2014) and others on factors that affect tax compliance. Following the demographic characteristic of taxpayers, Likert scale questions was separately developed which was used to ascertain factors affecting tax compliance of small and medium business profit taxpayers. The questionnaire were designed in such a way that the respondents state their opinion to the statements listed by putting a tick mark on one of their choices from five choices on the Likert scale (1= strongly disagree, 2= Disagree, 3=Neutral, 4= Agree and 5= strongly

agree).

3.7. Description of Variable and Model Specification

The dependent variable of this study was factors that affect Tax Compliance of small and Medium enterprises (TCSME) measured by taxpayers' tax compliance of timely tax payment, tax filling compliance and tax reporting compliance of the correct amount of tax due on taxpayers business.

3.7.1. Description of variables

The independent variables of this study were categorized as economic factor, tax system, social factor, individual factor and demographic factors that affect tax compliance of taxpayers.

Tax rate (TR): Tax rate mostly affects category 'C' taxpayers for which income tax liability is estimated by tax administration (Mehari & Pasha, 2017). The study by (Nigam, 2016; Mas'ud, Aliyu, & Gambo, 2014) showed tax burden in terms of tax rates is the main reason behind tax evasion and found tax rates has a negative influence on tax compliance.

Level of income (LOI): The empirical finding between level of income and tax compliance are ambiguous (Ahmed & Kedir, 2015). However, the study by (Gadi, 2016; Heenkenda, Weerasekara, & Chathurangani, 2016) showed that income levels of taxpayer have a significant positive correlation with tax compliance.

Fine and penalty (FP): Tax compliance is influenced by penalties and fine imposed on tax evasion (Beesoon, Soondram, & Jugurnath, 2016). The studies by (Appah & Wosowei, 2016; Gadi, 2016; Ahmed & Kedir, 2015; Tehulu & Dinberu, 2014) showed taxpayers' perception on penalties and fine have significant positive effect on tax compliance level.

Simplicity of tax system (STS): Tax simplification is making of the tax system simpler that have the potential to increase tax compliance (Muslichah, 2015). The study by (Ahmed & Kedir, 2015; Muslichah, 2015) found the simplicity of tax system by tax authority has significant positive effect on tax compliance of taxpayers in different countries.

Perception of government spending (PGS): Tax compliance is influenced by taxpayers' perception on government spending in response to tax revenue (Beesoon, Soondram, & Jugurnath, 2016). The study by (Gadi, 2016; Heenkenda, Weerasekara, & Chathurangani, 2016; Ahmed & Kedir, 2015; Tehulu & Dinberu, 2014) found that perceptions of taxpayers towards government spending showed significant positive correlation with tax compliance.

Tax Audit (TA): high tax audits lead to improved compliance and have a direct effect on tax collections of reported amount, additional penalties and taxes (Slemrod & Blumenthal (2011); Alm (2013) and Torgler (2012)). Audits are effective in recovering income on those who are audited.

Attitude towards tax (ATT): Taxpayers with positive attitude towards tax noncompliance are less compliant than taxpayers with negative attitude (Ahmed & Kedir, 2015). The study by (Gadi, 2016; Engida & Baisa, 2014) found taxpayers' attitude towards tax system shows significant positive effect on tax compliance levels of business taxpayers.

Rewards and Incentives (RI): giving positive recognition and incentives to loyal and honest tax payers. Strong desire of taxpayers to comply with the tax obligations are determined by the tax incentives towards tax compliance (Marziana & Ali (2017))

Tax knowledge & awareness (TKA): The tax knowledge on tax compliance was described in terms of education received on tax laws and regulations by taxpayers (Engida & Baisa, 2014). The study by (Olaoye, Agbaje, & Ajewole, 2017; Mehari & Pasha, 2017; Daniel, Akowe, & Awaje, 2016) (Fjeldstad, 2016) found tax knowledge had positive significant impacts on tax compliance.

3.7.2. Model specification

The model is specified based on previous studies conducted (Olaoye, Agbaje, & Ajewole, 2017; Redae & Sekhon, 2017; Manual & Xin, 2016; Ahmed & Kedir, 2015; Sapiei, Kasipillai, & Eze, 2014) in their study to assess determinants of tax compliance with regression model. The summation sign indicates as of the results of variables found in Likert scale question of dependent variable is used for analysis. The model specified takes the following specific form:

$$TCSME = \beta_0 + \beta_1 TR + \beta_2 LOI + \beta_3 FP + \beta_4 RI + \beta_5 STS + \beta_6 PGS + \beta_7 TA + \beta_8 ATT + \beta_9 TKA + \epsilon$$

Where: TCBSME is dependent variable of the study which is the level of **tax compliance behavior of small and medium enterprises** and the independent variables includes the following:

- ❖ **TR:** is tax rate of the tax authority;
- ❖ **LOI:** is level of income of taxpayer;
- ❖ **FP:** is the fine and penalty imposed on tax non-compliance;
- ❖ **RI:** is Rewards and Incentives
- ❖ **STS:** is the tax simplicity of tax system;
- ❖ **PGS:** is perceptions of government spending ;
- ❖ **TA:** is Tax Audit;

- ❖ **ATT:** is the Attitude Toward Tax;
- ❖ **TKA:** is taxpayers tax knowledge and Awareness;
- ❖ **β_0** the constant values of the estimated model;
- ❖ **$\beta_1, \beta_2 \dots$** coefficients of the independent variables
- ❖ And ε is the stochastic error of the study.

3.8. Methods of Data Analysis

Data collected was checked for the completeness and consistency of the responses, edited and then entered in Statistical Package for Social Science (SPSS) version 24 software. Descriptive analysis, cross tabulation, correlation and regression analysis were employed in data analysis. Type of regression model used for this data analysis was multiple regressions. The descriptive parts used frequency, percentages; followed by cross tabulation to check the significance of association between tax compliance and associated factors. Following the required diagnostic tests of data reliability, multicollinearity and others, correlation and regression analysis were conducted. The interpretation of the estimated model was done based on the coefficient of correlation and regression results.

4. RESULTS, DISCUSSIONS AND INTERPRETATIONS

4.1. Introduction

In this study, data collected from 386 small and medium enterprises found in Nekemte city was coded, entered in SPSS version 24 software and the result of the study was presented, analyzed and interpreted. The correlation and regression analysis of independent variables with dependent variables were described under this part.

4.2. Correlation Analysis

With an objective of measuring the strength of relationship between each independent variable with dependent variable Pearson correlation was used. The two significance levels used in correlation analysis are 0.05 and 0.01 that most researchers used. The estimates of correlation coefficients vary between -1 and +1 values between the two variables. According to (Karl E, 2012) Correlation Coefficients, the strength of relation between independent and dependent variable value of 0.8 to 1.0, 0.6 to 0.8, 0.4 to 0.6; and 0.2 to .4; and below 0.0 to 0.2 have very strong, strong, moderate, weak and very weak respectively. Depending on mentioned value of Karl E. correlation coefficients, the strength of relation between dependent and independent variables were interpreted for each of the variables under the study. A matrix of correlation coefficients was generated for 386 numbers of by Pearson correlation product moment as shown below.

Table 4.1: Correlation Coefficients Result

Correlations											
		TCB SME	TR	LOI	FP	RI	STS	PGS	TA	ATT	TKA
TCBSME	Corr.	1									
	Sig.										
Tax Rate (TR)	Corr.	-.192**	1								
	Sig.	.000									
Level Of Income(LOI)	Corr.	.327**	-.155**	1							
	Sig.	.000	.002								
Fine and Penalty (FP)	Corr.	.477**	-.086	.134**	1						
	Sig.	.000	.090	.008							
Rewards and Incentives (RI)	Corr.	.351**	-.033	.118*	.066	1					
	Sig.	.000	.519	.020	.198						
Simplicity Of Tax System (STS)	Corr.	.353**	-.010	.178**	.309**	-.015	1				
	Sig.	.000	.842	.000	.000	.767					
Perceptions of Gov. Spending (PGS)	Corr.	.307**	-.004	.126*	.038	-.036	.032	1			
	Sig.	.000	.943	.014	.459	.478	.530				
Tax Audit (TA)	Corr.	.326**	-.153**	.243**	.250**	-.074	.193**	.233**	1		
	Sig.	.000	.003	.000	.000	.147	.000	.000			
Attitude Toward Tax (ATT)	Corr.	.599**	-.115*	.091	.310**	.284**	.310**	.243**	.145**	1	
	Sig.	.000	.023	.073	.000	.000	.000	.000	.004		
Tax Knowledge and Awareness (TKA)	Corr.	.376**	.077	.228**	.160**	-.038	.218**	.312**	.347**	.278**	1
	Sig.	.000	.129	.000	.002	.454	.000	.000	.000	.000	
**. Correlation is significant at the 0.01 level (2-tailed).											
*. Correlation is significant at the 0.05 level (2-tailed).											

Source: Survey Data, 2020

As it can be seen from table 4.1, eight variables have positive significant relationship with dependent variable while one variable have negative significant relationship with dependent variable. As the result shows, Tax rate have statistically significant negative association (-0.192) with tax compliance behavior of small and medium enterprise at 1 percent ($p < 0.01$) significance level. This indicates that an increase in the tax rate leads to a decrease in tax compliance behavior of small and medium enterprises in the study area. Also the correlation between level of income and TCB of small and medium enterprises shows statistically significant positive association (0.327) with tax compliance behavior of small and medium enterprise at 1 percent ($p < 0.01$) significance level. This indicates that an increase in the level of taxpayers' income leads to an increased TCB of small and medium enterprises in the study area. The result of this study was supported by the work of (Heenkenda, Weerasekara, & Chathurangani, 2016) that found income levels of tax payer have a significant positive correlation with tax compliance. The correlation between fine and penalty also shows statistically significant positive association (0.477) with tax compliance behavior of small and medium enterprise at 1 percent ($p < 0.01$) significance level. This implies that an increase in fine and penalty rate would result in to higher compliance. The result of the study was supported by the work of (Nigam, 2016) that revealed legal sanctions in terms of penalties and fines shows positive association with tax compliance behavior of taxpayers. The result also shows there is statistically significant positive association (0.351) between rewards and incentives and tax compliance behavior of small and medium enterprise at 1 percent ($p < 0.01$) significance level. This implies that tax compliance increases significantly when tax payers found to be compliant are rewarded for their honesty. The result of the study was supported by the work of Ndekwa (2014) tax reward system strongly helps to improve level of tax compliance among SMEs in Tanzania. The correlation result also shows that, there is statistically significant positive association (0.353) between simplicity of tax system and tax compliance behavior of small and medium enterprise at 1 percent ($p < 0.01$) significance level. This means that, simplicity of tax returns and administration will improve tax compliance behavior of small and medium enterprises. The result is in line with (Razak & Adafula, 2013) which reveals that tax payers' levels of understanding of tax laws is positively correlated to a significant degree with their tax compliance decisions. The result on the table 4.1 also shows that there is statistically significant positive association (0.307) between perceptions of government spending and tax compliance behavior of small and medium enterprise at 1 percent ($p < 0.01$) significance level. This indicates that when the government improves the levels of accountability and transparency in tax governance taxpayers have more regard for in their compliance decisions. With respect to the correlation between Tax Audit and the TCB of small and medium enterprises, there is statistically significant positive association (0.326) at 1 percent ($p < 0.01$) significance level. The significant positive relationship finding between the tax audit by the tax authority and TCB of SME taxpayers implies an increase in the detection of tax evasion by the tax authority through audit leads to an increased TCB of taxpayers. That is, the higher the probability of detection by the auditor, the higher will be the compliance rate. The study was supported by (Beesoon, Soondram, & Jugurnath, 2016) that shown the probability of detection is strongly and significantly correlated with tax compliance. The result also shows, attitude toward tax have statistically significant positive association (0.599) with tax compliance behavior of small and medium enterprise at 1 percent ($p < 0.01$) significance level. This shows that positive attitude toward tax will improve the tax compliance behavior of small and medium enterprise. With respect to the correlation between Tax Knowledge and Awareness and the TCB of small and medium enterprises, there is statistically significant positive association (0.376) at 1 percent ($p < 0.01$) significance level. This implies that, an increase in tax knowledge of taxpayers leads to an increased TCB of taxpayers. The finding of this study was supported by the work of (Fjeldstad, 2016; Ahmed & Kedir, 2015) that found tax knowledge and awareness of the tax system is positively correlated with tax compliance.

4.4. Regression Model Assumption Test

The variance inflation factor (VIF) values below 10 are acceptable and tolerance value should be higher than 0.1. As it is observed from Regression Coefficients in the table 4.4; multicollinearity problem does not exist in this research because the value of tolerance is higher than 0.685 and variance inflation factors value is also less than 10. The most commonly used test is "Durbin-Watson test for autocorrelation" is based on the assumption that the errors in the regression model are generated by a first-order autoregressive process observed at equally spaced time periods. The Durbin-Watson statistic ranges in value from 0 to 4. A value near 2 indicates non-autocorrelation; a value toward 0 indicates positive autocorrelation; a value toward 4 indicates negative autocorrelation. The result of this study was 1.262, so the value indicates non-autocorrelation as seen on table 4.2.

4.5. Regression Analysis

In order to predict and explain the degree of association between dependent and determinants of tax compliance behavior of small and medium enterprises the regression model was used. Since, the regression is a powerful tool for summarizing the nature of relationship between variables and for making predictions of likely values of the dependent variable (Gujarati, 2004).

Table 4.2: Model Summary Result

Model Summary ^b					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.78 ^a	.618	.609	.35424	1.262

Source: Survey Data, 2020

The model summary Table 4.2; above shows the degree of association that the stated independent variables have with the dependent in the study area. As such, it has been shown by R that (tax rate, level of income, fine and penalty, Rewarding and incentives, simplicity of tax system, perceptions of government spending, tax audit, Attitude toward tax and tax knowledge and awareness) all together have relation with the dependent variable at a rate of 78%. This shows that the better these variables are treated the more TCB of small and medium enterprises would be improved. The estimated model shows that the R Square of .618 on table 4.2 implies that all the explanatory variables used in the study explain for about 61.8 percent of the variations level of factors affecting tax compliance behavior of small and medium enterprises but the remaining 38.2% variations level of factors affecting tax compliance behavior of small and medium enterprises are caused by other factors that are not included in the study.

Table 4.3: ANOVA Result

ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	76.380	9	8.487	67.631	.000b
	Residual	47.182	376	.125		
	Total	123.562	385			

Source: Survey Data, 2020

Similarly, the result of the study on table 4.3 shows that the values of the degree of freedom df (9, 385) with the F value of 67.631 with a significant level of $p < 0.000$ which implies that all the independent variables were jointly significant in explaining variation in factors that affect tax compliance behavior of small and medium enterprises in Nekemte city.

Table 4.4: Regression Coefficients Result

Coefficients ^a							
Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	-.064	.171		-.375	.708		
Tax Rate (TR)	-.067	.022	-.102	-3.067	.002	.915	1.093
Level of Income (LOI)	.085	.023	.129	3.760	.000	.858	1.166
Fine and penalty (FP)	.172	.023	.258	7.317	.000	.816	1.225
Rewards and incentives (RI)	.190	.026	.248	7.216	.000	.861	1.161
Simplicity of tax system(STS)	.080	.027	.107	3.015	.003	.805	1.243
Perceptions of Government spending (PGS)	.119	.028	.149	4.262	.000	.836	1.196
Tax Audit (TA)	.066	.028	.086	2.384	.018	.772	1.295
Attitude toward Tax(ATT)	.252	.032	.305	7.908	.000	.685	1.461
Tax knowledge and Awareness (TKA)	.119	.032	.138	3.718	.000	.737	1.358

a. Dependent Variable: TCBSME

Source: Survey Data, 2020

The regression equation estimated from the result of regression coefficient was explained as:

$$TCBSME = -.067 - 0.067TR + 0.085 LOI + 0.172FP + 0.190RI + 0.080STS + 0.119PGS + 0.066TA + .252ATT + 0.119TKA$$

As seen from table 4.4, the independent variables under study such as Tax Rate ($t = -3.06$, $p < 0.05$), Level of income ($t = 3.76$, $p < 0.05$), Fine and Penalty ($t = 7.31$, $p < 0.05$), Rewards and incentives ($t = 7.21$, $p < 0.05$), Simplicity of tax system ($t = 3.01$, $p < 0.05$), Perceptions of Government spending ($t = 4.26$, $p < 0.05$), Tax Audit ($t = 2.38$, $p < 0.05$), Attitude toward Tax ($t = 7.90$, $p < 0.05$), Tax knowledge and Awareness ($t = 3.71$, $p < 0.05$) significantly contribute for determining the tax compliance behavior of small and medium enterprises. To identify the individual contribution of explanatory variable, unstandardized coefficient Beta value of the model under study were used. As it can be seen from the table, the variable tax rate has statistically significant negative effect on the TCB of SME tax payers at 5 percent significance level. From the estimated equation, if all other variables were kept constant, an increase in the tax rate leads to a 0.064 decrease in TCB of SME taxpayers in the study area. That is, the more the tax rate becomes normal relative to business income, the less the TCB of SME tax payer will be. The

variable level of income has shown statistically significant positive effect on the TCB of SME taxpayers at 1 percent significance level. Based on the estimated regression equation, if all other variables in the regression analysis were kept constant, an increase in the level of income leads to a 0.085 increase on the TCB of SME taxpayers. That is, an increase in the level of income enhances the TCB of SME tax payers in the study area. The table also shows that Fine and penalty has statistically significant positive effect on the TCB of SME tax payers at 1 percent significance level. From the estimated equation, if all other variables were kept constant, an increase in fine and penalty leads to a 0.172 increase on the TCB of SME tax payers. Similarly Rewards and incentives have statistically significant positive effect on the TCB of SME tax payers at 1 percent significance level. From the estimated equation, if all other variables were kept constant, an increase in Rewards and incentives leads to a 0.190 increase on the TCB of SME tax payers. This means that tax compliance increases significantly when tax payers found to be compliant are rewarded for their honesty. With regard to Simplicity of tax system the study shows that it has statistically significant positive effect on the TCB of SME tax payers at 1 percent significance level. From the estimated equation, if all other variables were kept constant, an increase in Simplicity of tax system leads to 0.080 increases on the TCB of SME tax payers. This implies that simplification of the complexity of tax system improve TCB of SME taxpayers. As it can be seen from the table, perceptions of government spending have statistically significant positive effect on the TCB of SME tax payers at 5 percent significance level. From the estimated equation, if all other variables were kept constant, an increase in the perceptions of government spending leads to a 0.119 increase in TCB of SME taxpayers in the study area. This shows that when the more government improves the levels of accountability and transparency in tax governance the more improvement of the TCB of SME tax payers. With regard to tax Audit it has statistically significant positive effect on the TCB of SME tax payers at 5 percent significance level. From the estimated equation, if all other variables were kept constant, an increase in the Tax audit leads to a 0.066 increase in TCB of SME taxpayers in the study area. This implies that increase in the auditor's detection of non compliance of tax payers improves TCB of SME tax payers. The attitude toward tax variable also has statistically significant positive effect on the TCB of SME tax payers at 5 percent significance level. From the estimated equation, if all other variables were kept constant, an increase in the attitude toward tax leads to a 0.252 increase in TCB of SME taxpayers in the study area. This means that improvement in attitude toward tax by tax payers will improve their tax compliance behavior. The result of the study from the table also shows that tax knowledge and awareness has statistically significant positive effect on the TCB of SME tax payers at 5 percent significance level. From the estimated equation, if all other variables were kept constant, an increase in the tax knowledge and awareness leads to a 0.119 increase in TCB of SME taxpayers in the study area. This implies that an increase in the knowledge of the SME taxpayers on tax issues increases their tax compliance behavior.

5. Conclusion and Recommendation and policy implication

Conclusions

This study was undertaken on determinants of tax compliance behavior of small and medium enterprises tax payers in the east wollega zone of nekemte city administration, Ethiopia. For achieving what is aimed, primary data was collected using Linkert scale questionnaires and analyzed using descriptive statistical tools. Correlation and regression analysis was used to measure the strength of relationship and the degree of association between dependent and determinant factors of tax compliance behavior of small and medium enterprises tax payers. Nine determinants of tax compliance of tax payers were considered for this study namely Tax Rate, Level of income, fine and penalty, rewards and incentives, simplicity of tax system, perceptions of government spending, tax audit, attitude toward tax and tax knowledge and awareness. The correlation analysis of the study shows that there are statistically significant associations between independent factors and TCB of small and medium enterprises taxpayers. From these potential determinants, the findings of the investigation showed that tax compliance behavior of small and medium enterprises tax payers was negatively affected by tax rate and positively affected by Level of income, fine and penalty, rewards and incentives, simplicity of tax system, perceptions of government spending, tax audit, attitude toward tax and tax knowledge and awareness.

Recommendation

Based on the findings of the study, the following possible suggestions and policy implications could be forwarded. The study recommended that management of tax revenue authority has keep tax rates to the minimum as much as possible as high tax rate negatively affect tax compliance behavior of SME tax payers. The management and employees of tax revenue authority have to take in to account taxpayers' level of income in the process of tax liability determination so as to increases the TCB. The tax revenue authority staff has to work hard on the provision of tax education to increases tax knowledge of taxpayers so as to enhance the TCB of small and medium enterprises taxpayers. The tax revenue authority has to put legal sanctions in terms of penalties and fines on non compliant SME tax payers. The study also recommended that the tax revenue authority has to simplify tax filling and tax collection procedures so as to enhance the TCB of small and medium enterprises taxpayers. The government

should be transparent on how the revenue collected from tax payers has been used to enhance tax compliance behavior of small and medium enterprise. The study also recommended that the tax authority should provide rewards and incentives to honest small and medium enterprises tax payers to enhance tax compliance behavior of small and medium enterprises tax payers. Finally the study recommended that the tax authority should detect noncompliance SME tax payers through audit so as to increase their tax compliance behavior.

Policy implication

It is recommended that the tax policy makers have to reassess the current tax rate used for tax liability determination so as to increase the TCB of taxpayers and it is also recommended that the tax policy makers and the management of tax revenue authority have to reassess the current fine and penalty of tax noncompliance so as to enhance the TCB of taxpayers

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